SEVEN TACTICS

for Risk Management by Investors Seeking to Engage in Impact Investing

An ImpactAssets issue brief exploring critical concepts in impact investing

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Many investors are interested in engaging in impact investing, yet have questions regarding how to approach entering a new area of capital allocation. This Brief reviews seven tactics for managing risk, ranging from knowing one's personal risk profile to making use of fund and multi-manager strategies, and encourages investors to make good use of their investment professionals for guidance and engagement as they create—and execute—a strategy for impact investing.

INTRODUCTION

While Issue Brief #2 offers an overview for investors regarding risk, return and impact, this issue brief focuses in upon a more specific question: Fund managers, whether impact or traditional, all have ways to consider and manage risk in their portfolio. But what about the prospective impact investor herself?

What are some specific steps she can take to manage her risk on the way to capturing real returns with impact?

The good news is that while impact investing is a dynamic and exciting area in which investors may seek financial performance with social and environmental impact, you do not have to be a certified financial planner or analyst to understand its broad opportunities. Asset owners interested in doing so may participate in the development of a solid investment strategy for the allocation of investment capital. While there is obviously no "silver bullet" for successful impact investing or definitive checklist to guarantee success, there are a number of factors to consider in creating an impact investment approach which effectively seeks to manage risk.

We will review the following:

- Know What You Own: On Informed Investing and Moving From Black Box to Transparent Practices
- Evolving from Trading to Investing
- The Role—and Limits—of Advisors
- Fund Investing as a Risk Mitigation Tool
- The Potential Power of Multi-Manager Strategies
- Investing in Field Development As a Risk Mitigation Tool

KNOW YOUR RISK PROFILE

Risk can be relative. Some investors crave the potential of a home run while others are happy with hitting consecutive singles. Understand your own risk tolerance and profile—and then make no apology for it! Remember, as the old saying goes: nothing ventured, nothing gained. But at the same time, you do not have to bet the farm on a single opportunity. Many investors have found that moving progressively into various investment allocations over time allows them to become better educated regarding the difference between real and perceived risk, while building a robust portfolio that meets their various needs for income, long term blended value creation and impact. Regardless of how one approaches a final strategy, being clear on the level of risk you are comfortable with and what types of investments best compliment your overall goals is key to developing a successful approach to impact investing.

KNOW WHAT YOU OWN: ON INFORMED INVESTING AND MOVING FROM BLACK BOX TO TRANSPARENT PRACTICES

A classic refrain from traditional responsible investing is "Know What You Own"—and the same holds for impact investing. Perhaps the greatest lesson we can take from the debacle of 2008 is that too many investors allocated funds into investments they did not understand or allowed themselves to be directed into such investments without having kicked the tires and looked under the hood. Are you a registered investment professional? Most likely not, but that does not mean you cannot learn to ask the right questions and understand the fundamentals of how your investments are structured. If you are considering investing with a fund or investing with a firm that tells you, "Trust Us! We're the Experts!" and refuses to engage with you on a discussion of their investment strategy and specific holdings, don't. Period.

Fund managers and advisors should not be placed in the role of finance professors, yet at the same time a part of their responsibility to you as an investor is to explain their assumptions, investment strategy and processes. This holds true for both overall investment practices of the firm/fund as well as with regard to specific holdings they may have and about which you have questions. Recent years have shown us that often the "smartest guys in the room" were only smart about one thing—how to structure investments—but lacked perspective and transparency. Remember: it is your money—not theirs. If they do not engage you in a way that makes you feel respected, informed and engaged, find yourself another fund manager. There are plenty of competent, high performing managers from which to choose. Investors will find the ImpactAssets 50, a roster of impact investment fund managers vetted by a panel of experienced impact investors convened by ImpactAssets, a good starting place for information on investment managers.

EVOLVING FROM TRADING TO INVESTING

We have become accustomed to seeing the crawl line at the bottom of the screen, listing up to the minute firm performance and to hearing about the next great investment opportunity that cannot be missed—and we have seen something of what can happen when we all act like day traders. impact investing is about creating long-term value for capitalists and communities. Creating real, sustained value is not something that takes place in a matter of financial reporting quarters or even a few years. Know what level of real liquidity you require in order to meet your needs and then invest accordingly. Find fund managers and firms you trust, who you feel will be good stewards of your capital and who understand the investment mandate to generate financial returns with impact—but then let them do their job and build real value for you as long term investor. We live in a fast paced, "Show me the results!" world—but that is in some ways what is wrong with our society's approach to both money and life. This does not mean all your investments must be in "patient capital" investments or that all your funds should be managed along the lines of a "slow money" strategy—as sound and promising as such approaches to investing may be. But it does mean saplings don't grow into redwoods overnight. Be thoughtful, know your investment priorities, analyze the opportunity and then invest.

THE ROLE—AND LIMITS—OF ADVISORS

Perhaps your greatest risk mitigation tool is your investment advisor. Their perspective and knowledge of the field will be key to your success in impact investing. Trust them and heed their comments—but remember they are not the be all and end all of investment wisdom. Endorsing a final investment strategy and specific tactics is your responsibility and one you can manage. You cannot—and should not attempt—to off load your fiduciary responsibility onto your advisor. Doing so is not fair to either him or you!

And remember, impact investing is a growing and diverse investment category. Each day more advisors come forward who have significant experience in traditional investing and seek to transfer that knowledge into an impact investing approach. While they must possess or have access to impact expertise, simply because an advisor is newer to the discussion or is not nationally known as an impact investment advisor does not mean they will not serve you well in their role.

Part of the mission of ImpactAssets and others building the field of impact investing is to expand the tools and information available to mainstream wealth managers and investment advisors. As these resources become more readily available to traditional advisors, their ability to integrate impact investing practices within or as a complement to traditional investment approaches will grow. There will always be a place for advisory firms—but the future of creating a diverse, robust impact investing marketplace lies well beyond the capacity of such firms to serve a limited book of clients—and such firms benefit from the development of a more vibrant, liquid impact investment market. It is just as important for new impact investors to enter the market and, if appropriate, bring their existing advisors into the discussion and along on their journey.

With that in mind, remember that traditional investment advisors may not be incented to pursue an impact investment strategy or interested in adding impact investing tools to their offerings. Remember: you are the client and the way markets work is through supply and demand. It is up to you to voice your demands and if your needs are not being well served, seek your advice elsewhere—there is a growing pool of advisors ready to help you on your way!

FUND INVESTING AS A RISK MITIGATION TOOL

As discussed in other Issue Briefs, it is easy to conclude impact investing means direct investing in companies and social ventures working to change the world. And for a large number of investors, this is where the impact investing action is! Yet the majority of potential impact investors have neither the infrastructure nor expertise to manage a significant number of direct investments. For such investors, fund investing (wherein investors make investments with fund managers who in turn oversee a number of direct investments within a coordinated portfolio) may be the way to go. However, attend any conference on sustainable finance and impact investing and the newcomer may be quickly overwhelmed by the number and variety of fund managers from which to choose.

As part of its commitment to field building, ImpactAssets has created the ImpactAssets 50, which offers investors and advisors one more tool to identify and engage promising impact investment firms. By focusing upon fund managers and not on a specific product or fund an impact investment firm may have (since funds close and products evolve), the ImpactAssets 50 provides a broad overview of top firms across debt and direct equity investment strategies. Investors and advisors may then engage in their own due diligence of firms identified from this "short list" of vetted investment groups. ImpactAssets 50, together with other tools, such as GIIRS and ImpactBase, will also be helpful in helping wealth managers structure specific portfolios for clients.

THE POTENTIAL POWER OF MULTI-MANAGER STRATEGIES

If one is good, more can be better!

A multi-manager strategy[1] is one where a group of fund managers within a given thematic area (water, sustainable agriculture, micro-finance, education, etc.) are brought together into a single investment vehicle in which a large number of investors may place capital. The value of this approach is twofold. First, such multi-manager strategies decrease the cost and effort of individual fund managers engaging in their own fund raising. As odd as it may sound, sometimes fund managers and their teams will have to travel cross-country or overseas simply in pursuit of a single $100,000 investment. When multiplied across numerous investors, the fundraising costs can be significant, and much like the statistics of heads of nonprofits nationally that spend roughly 60% of their time in pursuit of funding versus actually doing the hard and good work of implementing their programs, fund managers often find themselves in the business of raising instead of deploying funds; when one takes into account the number of "dead end" conversations fund managers must pursue in order to find the diamonds in the rough, the costs increase exponentially.

Inclusion in a multi-manager fund helps significantly decrease these costs and allows fund managers to focus on their investment process as opposed to their fundraising. Second, from the investor's perspective, multi-manager strategies allow one to invest in a thematic area of real interest while diversifying the risk of doing so among a pool of other investors sharing the same impact agenda. As a nonprofit, financial services firm, ImpactAssets is working with both—investors/advisors and fund managers—in order to launch multi-manager investment vehicles that will meet the needs of all stakeholders while also making it possible to move much larger amounts of aggregated capital into the impact investing marketplace.

INVESTING IN FIELD DEVELOPMENT AS RISK MITIGATION

Finally, one frequently overlooked long-term risk mitigation strategy is that of field building. Everything you will read in your effort to learn more about impact investing and the lessons of those who've come before you have a cost. Someone felt this knowledge was worth developing and sharing with you and others to ensure all might learn from those who've gone before. Working as part of investor networks (both formal and informal) cultivating and disseminating this knowledge, attending conferences to present what will be your future lessons and supporting with philanthropic capital nonprofits working to expand the impact investing market are all options for every investor. "Each One, Teach

[1] Please note, we are not referring to a "fund of funds" approach, which would entail a higher fee structure than the more cost efficient and basic, multi-manager strategy being proposed here.

One" the organizing motto of Delancey Street, a leading social enterprise working with former prisoners and the drug addicted, is a good motto for all impact investors to adopt!

In conclusion, no investor should assume that following any one check list of considerations will make for success in impact investing. That said, considering one's risk tolerance and profile, participating in the knowledge development and dissemination of the field of impact investing and the other steps detailed here, may help you be better positioned for your investing future. There are a growing number of resources and advisors to help you on your way, so don't let a new strategy or investment approach throw you off the track. You are headed in the right direction and the only real failure would be in not capturing the full value you have the potential to create over the course of your investing future!

This ImpactAssets Issue Brief was authored by Jed Emerson, IA's Executive Vice President for Strategic Development. As part of ImpactAssets' role as a nonprofit financial services group, Issue Briefs are produced to provide investors, asset owners and advisors with concise, engaging overviews of critical concepts and topics within the field of impact investing. These Briefs will be produced by various ImpactAssets staff as well as collaborators and should be considered working papers—you're feedback on the ideas presented and topics addressed in IA Issue Briefs are critical to our development of effective information resources for the field. Please feel free to offer your thoughts on this Issue Brief, as well as suggestions for future topics, to Jed Emerson at **JEmerson@impactassets.org***. Additional information resources from the field of impact investing may be found at the IA website:* **www.ImpactAssets.org***. We encourage you to make use of them.*